

WEST VIRGINIA
SECRETARY OF STATE
KEN HECHLER
ADMINISTRATIVE LAW DIVISION

Form #4

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JAN 30 3 17 PM '97

CLERK OF WEST VIRGINIA
CECILIA W. HARRIS

NOTICE OF RULE MODIFICATION OF A PROPOSED RULE

AGENCY: Insurance Commissioner TITLE NUMBER: 114

CITE AUTHORITY W.Va. Code §§ 33-4-15 (h) and 33-2-10

AMENDMENT TO AN EXISTING RULE: YES NO

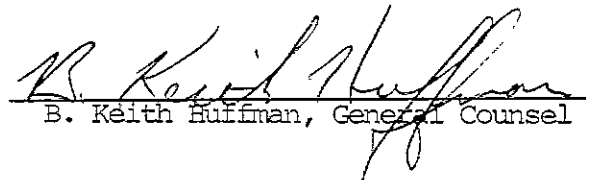
IF YES, SERIES NUMBER OF RULE BEING AMENDED: _____

TITLE OF RULE BEING AMENDED: _____

IF NO, SERIES NUMBER OF NEW RULE BEING PROPOSED: Series 48

TITLE OF RULE BEING PROPOSED: Life and Health Reinsurance Agreements

THE ABOVE PROPOSED LEGISLATIVE RULE, FOLLOWING REVIEW BY THE LEGISLATIVE RULE MAKING REVIEW COMMITTEE IS HEREBY MODIFIED AS A RESULT OF REVIEW AND COMMENT BY THE LEGISLATIVE RULE-MAKING REVIEW COMMITTEE. THE ATTACHED MODIFICATIONS ARE FILED WITH THE SECRETARY OF STATE.


B. Keith Huffman, General Counsel

4.40



STATE OF WEST VIRGINIA

Offices of the Insurance Commissioner

FILED

JAN 30 3 17 PM '97

Legal Division

CECIL UNDERWOOD
Governor

HANLEY C. CLARK
Insurance Commissioner

OFFICE OF THE WEST VIRGINIA
SECRETARY OF STATE

January 30, 1997

HAND DELIVERED

Ms. Judy Cooper, Director
Administrative Law Division
Office of Secretary of State
State Capitol
Charleston, West Virginia 25305

Dear Ms. Cooper:

Enclosed please find for filing one (1) copy of the following:

- (1) Notice of Rule Modification of a Proposed Rule;
- (2) Consent to Proposed Rule; and
- (3) The modified rule entitled "Life and Health Reinsurance Agreements." (Series 48)

Please contact me if further information is required.

Very truly yours,

Timothy Flynn
Associate Counsel

TH/cjs
Enclosures



STATE OF WEST VIRGINIA
Offices of the Insurance Commissioner

Legal Division

GASTON CAPERTON
Governor

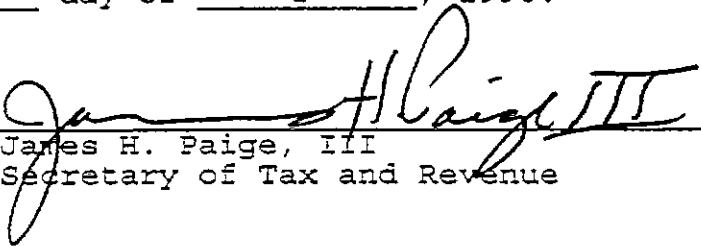
HANLEY C. CLARK
Insurance Commissioner

CONSENT TO PROPOSAL OF RULE

To Whom It May Concern:

Pursuant to West Virginia Code § 5F-2-2(a)(12), the undersigned hereby grants consent to the proposal of the following rule proposed by the Insurance Commissioner of the State of West Virginia: Title 114, Series 48, relating to Life and Health Reinsurance Agreements.

Signed this 9th day of May, 1996.


James H. Paige, III
Secretary of Tax and Revenue

114CSR48
TITLE 114
LEGISLATIVE RULE
INSURANCE COMMISSIONER

SERIES 48

LIFE AND HEALTH REINSURANCE AGREEMENTS

- §114-48-1. General
- §114-48-2. Preamble
- §114-48-3. Accounting Requirements
- §114-48-4. Written Agreements
- §114-48-5. Existing Agreements
- §114-48-6. Severability

114CSR48
TITLE 114
LEGISLATIVE RULE
INSURANCE COMMISSIONER

SERIES 48
LIFE AND HEALTH REINSURANCE AGREEMENTS

§114-48-1. General.

1.1. Scope. -- This rule shall apply to all domestic life and accident and sickness insurers and to all other licensed life and accident and sickness insurers which are not subject to a substantially similar rule in their domiciliary state. This rule shall also similarly apply to licensed property and casualty insurers with respect to their accident and sickness business. This rule shall not apply to assumption reinsurance, yearly renewable term reinsurance or certain nonproportional reinsurance such as stop loss or catastrophe reinsurance.

1.2. Authority. -- This rule is issued under the authority of W. Va. Code §§33-4-15(h) and 33-2-10.

1.3. Filing Date. --

1.4. Effective Date. --

§114-48-2. Preamble.

2.1. The West Virginia Insurance commissioner recognizes that licensed insurers routinely enter into reinsurance agreements that yield legitimate relief to the ceding insurer from strain to surplus.

2.2. However, it is improper for a licensed insurer, in the capacity of ceding insurer, to enter into reinsurance agreements for the principal purpose of producing significant surplus aid for the ceding insurer, typically on a temporary basis, while not transferring all of the significant risks inherent in the business being reinsured. In substance or effect, the expected potential liability to the ceding insurer remains basically unchanged by the reinsurance transaction, notwithstanding certain risk elements in the reinsurance agreement, such as catastrophic mortality or extraordinary survival. The terms of such agreements referred to herein and described in section 3 of this rule violate:

a. W.Va. Code §33-4-14(a), relating to financial statements which do not properly reflect the financial condition of the ceding insurer;

b. W.Va. Code §33-4-15(c), relating to reinsurance reserve credits, thus

resulting in a ceding insurer improperly reducing liabilities or establishing assets for reinsurance ceded; and

c. W.Va. Code § 33-10-5(j), relating to creating a situation that may be hazardous to policyholders and the people of this state.

§114-48-3. Accounting Requirements.

3.1. No insurer subject to this rule shall, for reinsurance ceded, reduce any liability or establish any asset in any financial statement filed with the commissioner if, by the terms of the reinsurance agreement, in substance or effect, any of the following conditions exist.

a. Renewal expense allowances provided or to be provided to the ceding insurer by the reinsurer in any accounting period, are not sufficient to cover anticipated allocable renewal expenses of the ceding insurer on the portion of the business reinsured, unless a liability is established on the ceding insurer's annual statement for the present value of the shortfall (using assumptions equal to the applicable statutory reserve basis on the business reinsured). Those expenses include commissions, premium taxes and direct expenses including, but not limited to, billing, valuation, claims and maintenance expected by the company at the time the business is reinsured.

b. The ceding insurer can be deprived of surplus or assets at the reinsurer's option or automatically upon the occurrence of some event, such as the insolvency of the ceding insurer. Termination of the reinsurance agreement by the reinsurer for nonpayment of reinsurance premiums or other amounts due, such as modified coinsurance reserve adjustments, interest and adjustments on funds withheld, and tax reimbursements, shall not be considered to be such a deprivation of surplus or assets.

c. The ceding insurer is required to reimburse the reinsurer for negative experience under the reinsurance agreement. Neither offsetting experience refunds against current and prior years' losses under the agreement nor payment by the ceding insurer of an amount equal to the current and prior years' losses under the agreement upon voluntary termination of in force reinsurance by the ceding insurer shall be considered a reimbursement to the reinsurer for negative experience. Voluntary termination does not include situations where termination occurs because of unreasonable provisions which allow the reinsurer to reduce its risk under the agreement. An example of such a provision is the right of the reinsurer to increase reinsurance premiums or risk and expense charges to excessive levels forcing the ceding company to prematurely terminate the reinsurance agreement.

d. The ceding insurer must, at specific points in time scheduled in the agreement, terminate or automatically recapture all or part of the reinsurance ceded.

e. The reinsurance agreement involves the possible payment by the ceding insurer to the reinsurer of amounts other than from income realized from the reinsured policies. For example, it is improper for a ceding company to pay reinsurance premiums, or other fees or charges to a reinsurer which are greater than the direct premiums collected by the ceding company.

f. The reinsurance agreement does not transfer all of the significant risk inherent in the business being reinsured. Table 114-48A identifies, for a representative sampling of products or type of business, the risks which are considered to be significant. For products not specifically included, the risks determined to be significant shall be consistent with this table.

1. The risk categories indicated in Table 114-48A are as follows.

A. Morbidity.

B. Mortality.

C. Lapse -- This is the risk that a policy will voluntarily terminate prior to the recoupment of a statutory surplus strain experienced at issue of the policy.

D. Credit Quality (C1) -- This is the risk that invested assets supporting the reinsured business will decrease in value. The main hazards are that assets will default or that there will be a decrease in earning power. It excludes market value declines due to changes in interest rate.

E. Reinvestment (C3) -- This is the risk that interest rates will fall and funds reinvested (coupon payments or monies received upon asset maturity or call) will therefore earn less than expected. If asset durations are less than liability durations, the mismatch will increase.

F. Disintermediation (C3) -- This is the risk that interest rates rise and policy loans and surrenders increase or maturing contracts do not renew at anticipated rates of renewal. If asset durations are greater than the liability durations, the mismatch will increase. Policyholders will move their funds into new products offering higher rates. The company may have to sell assets at a loss to provide for these withdrawals.

g. The credit quality, reinvestment, or disintermediation risk is significant for the business reinsured and the ceding company does not (other than for the classes of business excepted in paragraph 1 of subdivision g of this subsection) either transfer the underlying assets to the reinsurer or legally segregate such assets in a trust or escrow account or otherwise establish a mechanism satisfactory to the commissioner which legally segregates, by contract or contract provision, the underlying assets.

1. Notwithstanding the requirements of subdivision g of this subsection, the assets supporting the reserves for the following classes of business and any classes of business which do not have a significant credit quality, reinvestment or disintermediation risk may be held by the ceding company without segregation of such assets:

- A. Health insurance - LTC/LTD
- B. Traditional non-par permanent
- C. Traditional par permanent
- D. Adjustable premium permanent
- E. Indeterminate premium permanent
- F. Universal life fixed premium
(no dump-in premiums allowed)

2. The associated formula for determining the reserve interest rate adjustment must use a formula which reflects the ceding company's investment earnings and incorporates all realized and unrealized gains and losses reflected in the statutory statement. The following is an acceptable formula:

$$\text{Rate} = \frac{2(I + CG)}{X + Y - I - CG}$$

Where: I is the net investment income

CG is capital gains less capital losses

X is the current year cash and invested assets plus investment income due and accrued less borrowed money

Y is the same as X but for the prior year

h. Settlements are made less frequently than quarterly or payments due from the reinsurer are not made in cash within ninety (90) days of the settlement date.

i. The ceding insurer is required to make representations or warranties not reasonably related to the business being reinsured.

j. The ceding insurer is required to make representations or warranties about future performance of the business being reinsured.

k. The reinsurance agreement is entered into for the principal purpose of producing significant surplus aid for the ceding insurer, typically on a temporary basis, while not transferring all of the significant risks inherent in the business reinsured and, in substance or effect, the expected potential liability to the ceding insurer remains basically unchanged.

3.2. Notwithstanding subsection 3.1 of this rule, an insurer subject to this rule may, with the prior approval of the commissioner, take whatever reserve credit or establish whatever asset as the commissioner may deem consistent with applicable insurance statutes and rules, including actuarial interpretations or standards adopted by the commissioner.

3.3. Agreements entered into after the effective date of this rule which involve the reinsurance of business issued prior to the effective date of the agreements, along with any subsequent amendments thereto, shall be filed by the ceding company with the commissioner within thirty (30) days from its date of execution. Each filing shall include data detailing the financial impact of the transaction. The ceding insurer's actuary who signs the financial statement actuarial opinion with respect to valuation of reserves shall consider this rule and any applicable actuarial standards of practice when determining the proper credit in financial statements filed with the commissioner. The actuary should maintain adequate documentation and be prepared upon request to describe the actuarial work performed for inclusion in the financial statements and to demonstrate that such work conforms to this rule.

3.4. Any increase in surplus net of federal income tax resulting from arrangements described in subsection 3.3 of this rule, shall be identified separately on the insurer's statutory financial statement as a surplus item (aggregate write-ins for gains and losses in surplus in the

Capital and Surplus account) and recognition of the surplus increase as income shall be reflected on a net of tax basis in the "Reinsurance ceded" line as earnings emerge from the business reinsured.

a. (Example.) On the last day of calendar year N, company XYZ pays a \$20 million initial commission and expense allowance to company ABC for reinsuring an existing block of business. Assuming a 34% tax rate, the net increase in surplus at inception is \$13.2 million (\$20 million - \$6.8 million) which is reported on the "Aggregate write-ins for gains and losses in surplus" line in the Capital and Surplus account. \$6.8 million (34% of \$20 million) is reported as income on the "Commissions and expense allowances on reinsurance ceded" line of the Summary of Operations. At the end of year N + 1 the business has earned \$4 million. ABC has paid \$.5 million in profit and risk charges in arrears for the year and has received a \$1 million experience refund. Company ABC's annual statement would report \$1.65 million (66% of (\$4 million - \$1 million - \$.5 million) up to a maximum of \$13.2 million) on the "Commissions and expense allowance on reinsurance ceded" line of the Summary of Operations, and -\$1.65 million on the "Aggregate write-ins for gains and losses in surplus" line of the Capital and Surplus account. The experience refund would be reported separately as a miscellaneous income item in the Summary of Operations.

§114-48-4. Written Agreements.

4.1. No reinsurance agreement or amendment to any agreement may be used to reduce any liability or to establish any asset in any financial statement filed with the commissioner unless the agreement, amendment or a binding letter of intent has been duly executed by both parties no later than the "as of date" of the financial statement.

4.2. In the case of a letter of intent, a reinsurance agreement or an amendment to a reinsurance agreement must be executed within a reasonable period of time, not exceeding ninety (90) days from the execution date of the letter of intent, in order for credit to be granted for the reinsurance ceded.

4.3. The reinsurance agreement shall contain provisions which provide that:

a. The agreement shall constitute the entire agreement between the parties with respect to the business being reinsured thereunder and that there are no understandings between the parties other than as expressed in the agreement; and

b. Any change or modification to the agreement shall be null and void unless

Insurance Commissioner
Legislative Rule
Title 114, Series 48

made by amendment to the agreement and signed by both parties.

§114-48-5. Existing Agreements.

Insurers subject to this rule shall reduce to zero by December 31, 1998 any reserve credits or assets established with respect to reinsurance agreements entered into prior to the effective date of this rule which, under the provisions of this rule would not be entitled to recognition of the reserve credits or assets; provided, however, that the reinsurance agreements shall have been in compliance with laws or rules in existence immediately preceding the effective date of this rule.

§114-48-6. Severability.

If any provision of this rule, or their application to any person or circumstance, is held invalid, that determination shall not affect other provisions or applications of this rule which can be given effect without the invalid provision or application, and to that end the provisions of this rule are separable.

TABLE 114-48A

Product	Risk category					
	A	B	C	D	E	F
Health Insurance - other than LTC/LTD*	+	0	+	0	0	0
Health Insurance - LTC/LTD*	+	0	+	+	+	0
Immediate Annuities	0	+	0	+	+	0
Single Premium Deferred Annuities	0	0	+	+	+	+
Flexible Premium Deferred Annuities	0	0	+	+	+	+
Guaranteed Interest Contracts	0	0	0	+	+	+
Other Annuity Deposit Business	0	0	+	+	+	+
Single Premium Whole Life	0	+	+	+	+	+
Traditional Non-Par Permanent	0	+	+	+	+	+
Traditional Non-Par Term	0	+	+	0	0	0
Traditional Par Permanent	0	+	+	+	+	+
Traditional Par Term	0	+	+	0	0	0
Adjustable Premium Permanent	0	+	+	+	+	+
Indeterminate Premium Permanent	0	+	+	+	+	+
Universal Life Flexible Premium	0	+	+	+	+	+
Universal Life Fixed Premium	0	+	+	+	+	+
Universal Life Fixed Premium dump-in premiums allowed	0	+	+	+	+	+

*LTC = Long Term Care Insurance; LTD = Long Term Disability Insurance

+ - Significant 0 - Insignificant

1 committee and refiled in the state register on the twenty-
2 seventh day of November, one thousand nine hundred
3 ninety-five, relating to the insurance commissioner (health
4 maintenance organizations, 114 CSR 43), ~~are~~ is authorized.

5 (i) The legislative rule filed in the state register
6 on the twentieth day of August, one thousand nine hundred
7 ninety-six, authorized under the authority of section
8 fifteen, article four, chapter thirty-three, of this code,
9 modified by the insurance commissioner to meet the
10 objections of the legislative rule-making review committee
11 and refiled in the state register on the thirtieth day of
12 January, one thousand nine hundred ninety-seven, relating
13 to the insurance commissioner (life and health reinsurance
14 agreements, 114 CSR 48), is authorized.

15

16 ---NOTE: The purpose of this bill is to authorize the
17 Insurance Commissioner to promulgate a legislative rule
18 relating to Life and Health Reinsurance Agreements.

19

20 Strike-throughs indicate language that would be
21 stricken from the present law, and underscoring indicates
22 new language that would be added.

1 objections of the legislative rule-making review committee
2 and refiled in the state register on the twenty-seventh
3 day of November, one thousand nine hundred ninety-five,
4 relating to the insurance commissioner (minimum reserve
5 standards for individual and group health insurance
6 contracts, 114 CSR 44), ~~are~~ is authorized.

7 (h) The legislative ~~rules~~ rule filed in the state
8 register on the thirty-first day of July, one thousand nine
9 hundred ninety-five, authorized under the authority of
10 section twenty, article twenty-five-a, chapter thirty-
11 three of this code, modified by the insurance commissioner
12 to meet the objections of the legislative rule-making
13 review committee and refiled in the state register on the
14 twenty-seventh day of November, one thousand nine hundred
15 ninety-five, relating to the insurance commissioner (filing
16 procedures for health maintenance organizations, 114 CSR
17 46), ~~are~~ is authorized.

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19 register on the thirty-first day of July, one thousand nine
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23 meet the objections of the legislative rule-making review

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2 objections of the legislative rule-making review committee
3 and refiled in the state register on the twenty-seventh
4 day of November, one thousand nine hundred ninety-five,
5 relating to the insurance commissioner (recognizing
6 mortality tables for use in determining reserve liability
7 for annuities, 114 CSR 45), ~~are~~ is authorized.

8 (f) The legislative ~~rules~~ rule filed in the state
9 register on the twenty-eighth day of July, one thousand
10 nine hundred ninety-five, authorized under the authority of
11 section thirty-one-c, article six, chapter thirty-three of
12 this code, modified by the insurance commissioner to meet
13 the objections of the legislative rule-making review
14 committee and refiled in the state register on the
15 twenty-seventh day of November, one thousand nine hundred
16 ninety-five, relating to the insurance commissioner
17 (substandard risk motor vehicle insurance notice
18 requirements, 114 CSR 37), ~~are~~ is authorized.

19 (g) The legislative ~~rules~~ rule filed in the state
20 register on the twenty-eighth day of July, one thousand
21 nine hundred ninety-five, authorized under the authority of
22 section nine, article seven, chapter thirty-three of this
23 code, modified by the insurance commissioner to meet the

1 nine hundred ninety-five, authorized under the authority of
2 section eleven, article twelve, chapter thirty-three of
3 this code, modified by the insurance commissioner to meet
4 the objections of the legislative rule-making review
5 committee and refiled in the state register on the
6 twenty-seventh day of November, one thousand nine hundred
7 ninety-five, relating to the insurance commissioner (excess
8 line brokers, 114 CSR 20), ~~are~~ is authorized.

9 (d) The legislative ~~rules~~ rule filed in the state
10 register on the twenty-eighth day of July, one thousand
11 nine hundred ninety-five, authorized under the authority of
12 section ten, article two, chapter thirty-three of this
13 code, modified by the insurance commissioner to meet the
14 objections of the legislative rule-making review committee
15 and refiled in the state register on the twenty-seventh day
16 of November, one thousand nine hundred ninety-five,
17 relating to the insurance commissioner (continuing
18 education for insurance agents, 114 CSR 42), ~~are~~ is
19 authorized.

20 (e) The legislative ~~rules~~ rule filed in the state
21 register on the twenty-eighth day of July, one thousand
22 nine hundred ninety-five, authorized under the authority of
23 section nine, article seven, chapter thirty-three of this

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2 register on the twenty-seventh day of July, one thousand
3 nine hundred ninety-five, authorized under the authority of
4 section nine, article seven, chapter thirty-three of this
5 code, modified by the insurance commissioner to meet the
6 objections of the legislative rule-making review committee
7 and refiled in the state register on the twenty-seventh
8 day of November, one thousand nine hundred ninety-five,
9 relating to the insurance commissioner (actuarial opinion
10 and memorandum rule, 114 CSR 41), ~~are~~ is authorized.

11 (b) The legislative ~~rules~~ rule filed in the state
12 register on the twenty-seventh day of July, one thousand
13 nine hundred ninety-five, authorized under the authority of
14 section ten, article two, chapter thirty-three of this
15 code, modified by the insurance commissioner to meet the
16 objections of the legislative rule-making review committee
17 and refiled in the state register on the twenty-seventh day
18 of November, one thousand nine hundred ninety-five,
19 relating to the insurance commissioner (examiners'
20 compensation, qualifications and classification, 114 CSR
21 15), ~~are~~ is authorized.

22 (c) The legislative ~~rules~~ rule filed in the state
23 register on the twenty-eighth day of July, one thousand

87EB

1 Bill-Ins, Life (By Delegate(s) Douglas, Hunt, Compton,
2 Faircloth, Linch and Riggs)

3
4 [Introduced March 3, 1997; referred to the
5 Committee on Banking and Insurance then the
6 Judiciary.]
7
8
9

10 A BILL to amend and reenact section three, article seven,
11 chapter sixty-four of the code of West Virginia, one
12 thousand nine hundred thirty-one, as amended, relating
13 to authorizing the insurance commissioner to
14 promulgate a legislative rule relating to life and
15 health reinsurance agreements.

16 Be it enacted by the Legislature of West Virginia:

17 That section three, article seven, chapter sixty-four
18 of the code of West Virginia, one thousand nine hundred
19 thirty-one, as amended, be amended and reenacted, to read
20 as follows:

21 ARTICLE 7. AUTHORIZATION FOR DEPARTMENT OF TAX AND REVENUE
22 TO PROMULGATE LEGISLATIVE RULES.

23 §64-7-3. Insurance commissioner.

114-48

1 committee and refiled in the state register on the twenty-
2 seventh day of November, one thousand nine hundred
3 ninety-five, relating to the insurance commissioner (health
4 maintenance organizations, 114 CSR 43), ~~are~~ is authorized.

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10 objections of the legislative rule-making review committee
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12 January, one thousand nine hundred ninety-seven, relating
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16 NOTE: The purpose of this bill is to authorize the
17 Insurance Commissioner to promulgate a legislative rule
18 relating to Life and Health Reinsurance Agreements.

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20 Strike-throughs indicate language that would be
21 stricken from the present law, and underscoring indicates
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8 register on the thirty-first day of July, one thousand nine
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1 nine hundred ninety-five, authorized under the authority of
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11 nine hundred ninety-five, authorized under the authority of
12 section ten, article two, chapter thirty-three of this
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14 objections of the legislative rule-making review committee
15 and refiled in the state register on the twenty-seventh day
16 of November, one thousand nine hundred ninety-five,
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17 and refiled in the state register on the twenty-seventh day
18 of November, one thousand nine hundred ninety-five,
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21 15), ~~are~~ is authorized.

22 (c) The legislative ~~rules~~ rule filed in the state
23 register on the twenty-eighth day of July, one thousand

Senate Bill No. 186

1 (By Senator(s) Ross, Anderson, Macnaughtan,
2 Boley and Buckalew)

3 [Introduced March 3, 1997; referred to the
4 Committee on Banking and Insurance; and then to
5 the Committee on the Judiciary.]
6
7
8
9

10 A BILL to amend and reenact section three, article seven,
11 chapter sixty-four of the code of West Virginia, one
12 thousand nine hundred thirty-one, as amended, relating
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15 health reinsurance agreements.

16 *Be it enacted by the Legislature of West Virginia:*

17 That section three, article seven, chapter sixty-four
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20 as follows:

21 ARTICLE 7. AUTHORIZATION FOR DEPARTMENT OF TAX AND REVENUE

22 TO PROMULGATE LEGISLATIVE RULES.

23 §64-7-3. Insurance commissioner.

114-48

ANALYSIS OF PROPOSED LEGISLATIVE RULE

STAFF COUNSEL: Rita A. Pauley

AGENCY: Insurance Commissioner

SUBJECT: Life and Health Reinsurance Agreements, 114-CSR-48

PERTINENT DATES

Filed for public comment:	May 31, 1996
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Filed LRMRC:	August 20, 1996
Filed as emergency:	May 31, 1996
Fiscal Impact:	None

ABSTRACT

This rule adopts the model regulation on Life and Health Reinsurance Agreements of the National Association of Insurance Commissioners. The rule effectuates the provisions of House Bill 4387 passed during the 1996 regular session which sets forth accounting standards for certain reinsurance agreements. The standards, required by legislation and specified in this rule, are to be applied by the insurers in preparing annual financial statements that must be submitted to the Insurance Commissioner. One side effect of the rule is that it regulates the reinsurance agreement itself by prohibiting insurance companies from reducing any liability or establishing any asset in any financial statement if the reinsurance agreement does not meet the requirements of this rule.

An insurance company's financial condition is determined according to detailed standards and procedures promulgated by the National Association of Insurance Commissioners (NAIC). Each West Virginia insurance company is required to submit an annual statement of its financial condition to the Commissioner using an NAIC statement form. The determination that a company is

impaired or insolvent is based on the information required in the company's annual statement. Those determinations are made in large part by NAIC standards and procedures.

A reinsurance agreement or treaty is a device by which a ceding insurance company transfers the risk associated with a policy or group of policies to a second insurance company, the reinsurer. Under the agreement the reinsurer agrees to pay the ceding insurer the amount of the claims due under these policies. In return, the ceding insurer pays the reinsurer certain reinsurance charges. Typically, these charges are equal to the premiums received by the ceding insurer for the policies, less a commission retained by the ceding insurer and less the ceding insurer's cost to maintain the policies. The insured will still look to the ceding insurer for payment of a claim, however, the ceding insurer may then recover the amount of payment from the reinsurer.

This rule was filed as an emergency rule on May 31, 1996 and is currently in effect. This was done in order to ensure that the rule would be in place as required by the National Association of Insurance Commissioners.

The proposed rule is new. The following is a section by section synopsis of the proposed rule.

This rule should have a definition section for those terms which have a specialized meaning in the insurance industry such as ceding insurer, catastrophic mortality and renewal expense allowances.

Counsel has suggested that the agency agree to develop definitions, with the assistance or approval of the accreditation entity, to make the rule more understandable. The agency is concerned that any change in the model rule will cause the agency not to be accredited by the National Association of Insurance Commissioners. The agency has indicated that the terms in question are evolving on a national level and that it may not be possible to properly and adequately define them. The agency is working with counsel to insure that the rule meets the statutory requirements of rule making while at the same time maintain the substantive requirements of the model rule.

Section 1 is the standard general section setting forth the scope, authority, filing and effective dates of the rule. The rule applies to all domestic life and accident and sickness insurers. However, West Virginia Code §33-4-15b, the cited authorizing statute, only applies to life insurance companies. The authorizing statute should be §33-4-15.

Section 2 is the preamble. It contains a general policy statement. The preamble recognizes the value of legitimate reinsurance agreements. At the same time it denounces the use of reinsurance agreements to create surplus aid. It also includes an admonition about terms in reinsurance agreements which violate three sections of the West Virginia Code.

Section 3 sets forth the accounting requirements for reinsurance agreements. One effect of the rule is to regulate the agreement between the ceding insurer and the reinsurer.

Insurers are prohibited from reducing any liability or establishing any asset in the financial statement if the reinsurance agreement does not meet the requirements of this rule. The rule determines when a reinsurance agreement may be recognized by an insurance company in preparing its annual statement, or by the Insurance Commissioner in assessing an insurance company's solvency. This is one way to prohibit a ceding insurer from entering into a bogus reinsurance agreement to make it appear that the insurer is in better financial condition than it actually is. For example, the ceding insurer is allowed to recover operating expenses under the reinsurance agreement. The ceding insurer anticipates what it will cost it to operate its business and maintain the insurance accounts it has sold to its customers. If the agreement does not adequately cover those allowable expenses the ceding insurer retains a liability that should have been shifted to the reinsurer. The agreement is binding and enforceable between the parties but the ceding insurer must show the liability on its financial statement or it can not claim credit for a surplus which would normally result from the agreement.

Subsection 3.1.f states that the reinsurance agreement must transfer all of the significant risk inherent in the insurance which was reinsured. This subsection refers to a table included

as an appendix to the rule and then explains risk factors contained in the rule. If a specific type of insurance is not listed in the table the insurer is to determine which of the risk factors are significant for that type of insurance. The transfer of risk for new types of insurance is to be transferred by the reinsurance agreement in accordance with this rule.

Subsection 3.1.g provides that the assets of insurance with significant credit quality, reinvestment or disintermediation risks which has been reinsured must be transferred to the reinsurer, legally segregated in a trust or escrow account or segregated by contract or contract provision from the other assets of the ceding insurer.

Subsection 3.2 contains a proviso that an insurer may, with the prior approval of the Commissioner, take reserve credit or establish assets that are constant with applicable insurance statutes and rules.

Section 4 requires reinsurance agreements, amendments to reinsurance agreements and binding letters of intent to be in writing. If a binding letter of intent is executed a reinsurance agreement or an amendment to an agreement must be completed within 90 days of the letter of intent in order to receive credit on the annual financial statement. The reinsurance agreement must contain a provision that the agreement is the full agreement between the parties and that there are no understandings not expressed in the agreement. It must also specify that any change or modification to the agreement must be in writing and signed by both parties.

Section 5 covers existing agreements. Reinsurance agreements, entered into prior to the effective date of this rule that do not meet the current standards but were in compliance with the law and rules when they were entered into, have until December 31, 1998 to zero out any assets or reserve credits claimed by the insurers.

Section 6 is a standard severability provision.

AUTHORITY

Statutory authority: W. Va. Code, § 33-4-15(h) provides in part.

§33-4-15. Reinsurance.

(h) The commissioner shall promulgate rules and regulations pursuant to chapter twenty-nine-a of this code for the implementation and administration of the provisions of this section to include, but not be limited to, the type of assumption agreements subject to the provisions of this section, their content and the standards the commissioner may utilize in reviewing the agreements.

ANALYSIS

I. Has the agency exceeded the scope of its statutory authority in approving the proposed legislative rule?

NO.

II. Is the proposed legislative rule in conformity with the intent of the Statute which the rule is intended to implement, extend, apply, interpret or make specific?

YES.

III. Does the proposed legislative rule conflict with other code provisions or with any other rule adopted by the same or a different agency?

NO.

IV. Is the proposed legislative rule in conflict with other code provisions or with any other rule adopted by the same or a different agency?

NO.

V. Is the proposed legislative rule reasonable, especially as it affects the convenience of the general public or of persons

affected by it?

This rule would not be at all convenient for the general public. However, the agency contends that the rule is directed to a very narrow audience, insurance company actuaries, and it would be perfectly reasonable to that audience.

VI. Can the proposed legislative rule be made less complex or more readily understandable by the general public?

The rule must in some way define its terms in order to be understandable to anyone. In discussions with agency counsel and an accountant it was apparent that they are not entirely clear and in agreement on the meaning of parts of this rule.

VII. Was the proposed legislative rule promulgated in compliance with the requirements of Chapter 29A, Article 3 and with any requirements imposed by any other provision of the code?

YES.

VIII. Other.

Counsel has suggested technical changes.